BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Investigation into the Overearnings of Northeast Missouri Rural Telephone Company.	)))	Case No. TO-98-216
In the Matter of the Proposed Tariff Sheets of Northeast Missouri Rural Telephone Company.	)))	Case No. TT-98-277

REPORT AND ORDER

Issue Date: August 18, 1998

Effective Date: August 28, 1998

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APPEARANCES

Craig S. Johnson, Andereck, Evans, Milne, Peace & Baumhoer, P.O. 1438, Jefferson City, Missouri 65102, Northeast Missouri Rural Telephone Company.

Leo J. Bub, Attorney, Southwestern Bell Telephone Company, One Bell Center, Room 3518, St. Louis, Missouri 63101, for Southwestern Bell Telephone Company.

Paul S. DeFord, Lathrop & Gage L.C., 2345 Grand Boulevard, Suite 2500, Kansas City, Missouri 64108, for AT&T Communications of the Southwest, Inc.

Michael F. Dandino, Senior Counsel, Deputy Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Roger W. Steiner, Assistant General Counsel, and **Marc D. Poston**, Assistant General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: **Amy E. Randles.**

REPORT AND ORDER

Background

On November 21, 1997, the Staff of the Missouri Public Service Commission (Staff) filed a pleading entitled "Motion to Open Docket" with the Commission in which it requested the Commission to open a case to consider the Stipulation and Agreement (Agreement) reached between Staff, the Office of the Public Counsel (OPC), Northeast Missouri Rural Telephone Company (Northeast) and AT&T Communications of the Southwest, Inc. (AT&T)[1] that was filed with Staff's motion. A copy of the Agreement is attached to this Report and Order (Attachment 1).

In its motion, Staff alleged that it had initiated an overearnings investigation of Northeast in May of 1997, and that Staff, AT&T, OPC, Northeast and Southwestern Bell Telephone Company (SWBT) discussed Staff's preliminary per book earnings analysis. These discussions resulted in the nonunanimous Agreement proposed by Staff, AT&T, OPC and Northeast, which would reduce Northeast's revenues by approximately $222,595 annually. Under the proposed Agreement, Northeast's charges for Originating CCL, Terminating CCL, Local Transport, Local Switching, Directory Assistance and other parts of

[1] Northeast, Staff, OPC and AT&T shall be referred to collectively as the "signatory" or "stipulating" parties throughout this Report and Order.

access would be lowered and its intraLATA and interLATA rates would be equalized. The Commission established Case No. TO-98-216 to determine whether the nonunanimous Agreement should be approved.

Northeast filed a proposed tariff (File No. 9800470) on December 8, for Commission approval. This tariff filing would implement the rate restructuring plan proposed in the nonunanimous Agreement that was filed by the Staff on November 21. Case No. TO-98-277 was established to consider Northeast's tariff filing.

The Stipulation and Agreement, and Northeast's implementing tariff, present numerous interrelated issues for decision by the Commission. The parties do not dispute whether the proposed revenue reduction amount is appropriate. Rather, all parties agree with the goals of reducing Northeast's revenues by approximately $222,595 annually, and of reducing access rates to achieve the reduction. The dispute focuses on how these goals should be achieved. One issue in dispute is whether intraLATA and interLATA access rates should be equalized. Related to this issue is whether the cap for originating and terminating CCL minutes of use should be eliminated. The parties also dispute whether the Commission should use 1996 or 1997 minutes of use together with the revenues of the company in order to determine the appropriate access rates, and whether the intended revenue reduction will be achieved under either of these scenarios. In addition to these issues, the Commission must determine whether the proposed Agreement and tariffs are in the public interest.

Procedural History

On December 16, the Commission issued an order establishing Case No. TO-98-216 to consider the Agreement. In its order, the Commission

granted intervention to SWBT and gave notice of the case, establishing a deadline of January 2, 1998 for further applications to intervene. The Commission also established dates for a prehearing conference and an evidentiary hearing. AT&T applied for intervention on December 29, 1997, and the Commission granted AT&T permission to intervene at the prehearing conference held on January 5, 1998. There were no other intervenors. On January 6, the Commission consolidated Case No. TT-98-277 with Case No. TO-98-216, designating Case No. TO-98-216 as the lead case. On January 6, the Commission suspended the effective date of the tariff to July 7.

The Commission held an evidentiary hearing concerning the proposed Agreement on May 11, following which the parties submitted late filed Exhibits 11, 12, 13, 16 and 16HC. Northeast filed a pleading on May 18 indicating that it consented to a further suspension of its tariff for up to 60 days. Initial briefs were filed on June 8, and reply briefs were filed on June 18. On July 2, the Commission suspended Northeast's tariff for an additional 30 days, to August 6, in order that the Commission would have adequate time to review the record and render a decision. On August 5, the Commission suspended Northeast's tariff for an additional 15 days, to August 21, in order to complete the process of rendering a decision.

Evidentiary Rulings

At the hearing, SWBT offered into evidence Exhibit 14HC, consisting of AT&T's responses to seven data requests that had been propounded to AT&T by SWBT. The exhibit consists of seven pages, with one Data Request per page. Data Requests 1 through 6 called for AT&T's intraLATA and interLATA average lengths of haul, average revenue per

minute, and average call duration for its intrastate traffic. Data Request 7 asked for the percentages of intraLATA and interLATA traffic carried by AT&T out of Northeast's exchanges. AT&T had answered the Data Requests after the Commission granted SWBT's motion to compel answers. AT&T had not opposed SWBT's motion to compel answers to SWBT's discovery while the motion was pending before the Commission.

Northeast and Staff objected to the entire exhibit on the grounds that SWBT had not demonstrated an adequate foundation for the seven Data Request answers. Northeast further asserted a hearsay objection to Exhibit 14HC. AT&T objected to Data Requests 1 through 6 on the grounds of relevance.

SWBT responded to the relevance objection by arguing that the information contained in Exhibit 14HC would demonstrate that interLATA carriers have a greater ability to contribute to Northeast's switched access revenues than do intraLATA carriers. SWBT elicited testimony from an AT&T witness, who testified that he was aware of the content of the data requests propounded by SWBT and that he had supervised the preparation of the answer to Data Request 7. The witness was not aware of who had prepared the answers provided to Data Requests 1 through 6, how these answers had been prepared, or whether they were accurate. SWBT responded to the hearsay objection by arguing that AT&T's answers constituted admissions against interest, thus defeating the hearsay objection. On May 22, SWBT filed suggestions in support of the admission of Exhibit 14HC. SWBT restated its arguments concerning relevance and cited cases that purportedly support its assertion that the answers to Data Requests 1 through 7 are AT&T's admissions against SWBT, a party opponent, and therefore may be admitted under an exception to the hearsay rule. SWBT also cited a case in support of its position that a party's

admissions against interest may be received in evidence during an opponent's case without calling the person making the admission to the stand.

The Commission finds that SWBT clearly established a proper foundation for Data Request 7. It is questionable whether SWBT met the technical requirements for establishing a proper foundation for AT&T's answers to Data Requests 1 through 6. The Commission is not bound by the technical rules of evidence. § 386.410.1, RSMo Supp. 1997. For this reason, the Commission will overrule the foundation objections to Exhibit 14HC.

Moreover, the Commission finds that Northeast's hearsay objection to Exhibit 14HC should be overruled. Although none of the cases cited by SWBT are clearly applicable to a situation where parties who did not make the admission object on hearsay grounds, the Commission is not bound by the technical rules of evidence. § 386.410.1, RSMo Supp. 1997.

However, the Commission finds that Data Requests 1 through 6 are not relevant to the issues before the Commission because they are not tied specifically to traffic in Northeast's exchanges. Rather, they involve AT&T revenue information on a statewide basis. Although the Commission granted SWBT's motion to compel AT&T's answers to these Data Requests, the Commission did so in light of AT&t's failure to respond to SWBT's motion to compel and the Commission did not make a finding as to the information's relevance in its order granting the motion.

The Commission therefore sustains the relevancy objection to pages 1 through 6 of Exhibit 14HC, but overrules the hearsay and foundation objections to the entire exhibit and admits page 7 of Exhibit 14HC.

The Commission issued notices regarding late filed Exhibits 11, 12, 13, 16 and 16HC on June 3 and 17, permitting the parties an opportunity to object. No party objected to the admission of any of these exhibits. Therefore, the Commission admits late filed Exhibits 11, 12, 13, 16 and 16HC.

Findings of Fact

The Missouri Public Service Commission has considered all of the competent and substantial evidence upon the whole record in order to make the following findings of fact. The Commission has also considered the positions and arguments of all of the parties in making these findings. Failure to specifically address a particular item offered into evidence or a position or argument made by a party does not indicate that the Commission has not considered it. Rather, the omitted material was not dispositive of the issues before the Commission.

A. Equalization of IntraLATA and InterLATA Access Rates and Elimination of CCL Cap

The primary issues in dispute are whether intraLATA and interLATA access rates should be brought into parity and whether the CCL cap should be eliminated, as the stipulating parties have agreed to. In Northeast's exchanges, the current and proposed composite access rates are as follows:

	Existing Rates		Proposed Rates
	IntraLATA	**InterLATA**	**IntraLATA and InterLATA**
Composite Originating Rate	0.105034	0.135997	0.092997
Composite Terminating Rate	0.133412	0.200197	0.130317

The current disparity between intraLATA and interLATA switched access rates exists because, in January of 1987, the interLATA rates were set at a level to recover the cost of service as determined by the prior interLATA access pool, and in July of 1988, the intraLATA rates were set at a level to recover the cost of service as determined by the prior intraLATA toll pool settlements during a test period. Because the intraLATA and interLATA toll pools were dissolved at different points in time, with different study period calling volumes and different revenue requirements, the intraLATA access rates ended up lower than interLATA rates, and there has been no CCL cap for interLATA rates. *See* Exh. 3, page 7.

Also, currently a "cap" exists on the number of intraLATA access minutes for which Northeast may charge a higher Carrier Common Line (CCL) rate; the cap is 3,286,714 minutes for originating access and 2,782,731 for terminating access. After these caps have been reached in a given calendar year, Northeast charges a lower, "after cap" discount rate for each minute of use. The CCL cap is designed so that, once a certain level of access usage occurs in a year which permits recovery of the non-usage sensitive costs of providing access, access rates are discounted appropriately. Exh. 3, page 11. The signatories propose to eliminate the cap and the attendant two tiered rate structure and replace it with single rates that will apply to originating CCL and terminating CCL, respectively, regardless of the number of minutes of use experienced by Northeast in any given year, as follows:

	Existing Rates		Proposed Rates
	IntraLATA	**InterLATA**	**IntraLATA and InterLATA**
Originating CCL	0.076100	0.090000	0.047000
Terminating CCL	0.130400	0.154200	0.084320
Originating CCL after CAP	0.009100	0.090000	0.047000
Terminating CCL after CAP	0.015500	0.154200	0.084320

See Schedule 1 to Exh. 8. According to Northeast's witness Godfrey, the proposal would reduce intraLATA access revenue by $103,760, or 6.7%, and would reduce interLATA access revenue by $118,835, or 33.9%. Approximately 47% of the revenue reduction would be accomplished by lowering intraLATA access rates and approximately 53% of the revenue reduction would be accomplished by lowering interLATA access rates.

SWBT, the only party opposing the Agreement, alleges that intraLATA and interLATA access rates were originally determined by considering the contributions made to access revenues by various groups of providers, namely intraLATA versus interLATA providers. Typically, intraLATA access providers such as SWBT contributed more to access revenues than interLATA providers such as AT&T, in spite of the lower per minute intraLATA access rates, because there were more minutes of use in intraLATA service than in interLATA service[2]. According to SWBT, the Commission also gave consideration to the fact that interLATA toll produces a higher average revenue per minute than intraLATA toll, so that

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[2] *See* Attachment A to Agreement (Attachment 1). Currently, the only portion of intraLATA access rates that is more expensive than its interLATA counterpart is the Local Transport element. This causes Northeast's intraLATA composite originating rate below the cap to be higher than its interLATA composite originating rate below the cap. However, Northeast's overall intraLATA composite originating rate is still lower than its overall interLATA composite originating rate.

interLATA service providers could afford to contribute more to access revenues on a per minute basis than could intraLATA service providers.

For these reasons, SWBT asserts that any reduction in access revenue should be distributed by lowering intraLATA access rates more than interLATA access rates. Specifically, SWBT asserts that the respective rates should be set so that 81.5% of Northeast's revenue reduction should be achieved through lowering intraLATA access rates rather than interLATA access rates. This proposal is based on the fact that intraLATA access produced 81.5% of Northeast's total access revenue in 1996. SWBT's proposed distribution would recognize SWBT's and other intraLATA service providers' historically higher contribution to Northeast's overearnings and reflect the continued ability of interLATA service providers to pay more per minute in access while staying profitable.

SWBT opposes the elimination of the intraLATA CCL cap because SWBT claims that the proposal effectively amounts to a rate increase for access minutes of use above the test period level. SWBT alleges that the "after cap" discount rate will no longer be available and that the proposed decrease in Northeast's "pre-cap" originating and terminating CCL rates will not be enough to offset the higher cost for minutes of use above the current cap. SWBT suggests that the CCL cap should be updated rather than eliminated. According to SWBT, after the 1997 usage levels are used to proportionately distribute reductions between pre-cap interLATA and intraLATA access rates as SWBT proposes, the actual 1997 usage levels could become the new cap levels. SWBT suggests that usage above the 1997 level (the new cap) should be charged for at the current

post-cap rates charged by Northeast, so that a discount continues to apply.

The signatories to the Agreement argue that intraLATA and interLATA access rates should be equalized because the costs of provisioning these services are in most respects identical. They emphasize that other companies have equalized intraLATA and interLATA access rates and eliminated the CCL cap. They argue that the current difference in access rates is unjustified and inappropriate in light of the federal Telecommunications Act of 1996 (the Act), 47 U.S.C. § 151 et seq., because the historical difference in rates came about as a result of divestiture proceedings. The Commission's primary goal under the Act is to promote competition as the vestiges of divestiture are slowly being dismantled. Considerations such as the relative profit margins, ability to contribute and historical contributions of companies serving different market segments should not influence the Commission's decision in the new atmosphere of free market competition.

In addition, they emphasize that in overearnings proceedings, the amount of overearnings is calculated by looking at the subject company's total revenues without respect to which group of ratepayers generated the excess revenues. They argue that rate design is forward-looking and should prevent the subject company from overearning in the future. Rate design is not supposed to allow a rate-paying group to recover what has been paid in the past. They also dispute whether interLATA toll service remains more profitable than intraLATA toll service today. Finally, they presented evidence that other secondary carriers, such as Green Hills Telephone Company, Citizens Telephone company and Steeleville Telephone

Exchange have been permitted to institute intraLATA and interLATA access rate parity.

With respect to the CCL cap, the stipulating parties point out that the cap currently produces the odd result that a minute of access could cost more to ratepayers in December than in January, even though the cost of providing switched access has not changed. They point out that SWBT and 14 other local exchange carriers in Missouri currently do not have a cap. They also assert that the cap will be difficult to administer when multiple competitive carriers are providing service.

B. 1996 Versus 1997 Minutes of Use/Achievement of Revenue Reduction

SWBT asserts that the access rates proposed under the Agreement will not achieve the intended revenue reduction of $222,595 because Northeast has experienced an average annual growth rate of 12.3% in its access minutes of use since divestiture. The parties to the Agreement used 1996 as their test year. SWBT argues that the proposed access rates will not achieve a significant revenue reduction, and might even result in a revenue increase, because 1996 usage levels are not the usage levels to which the rates will be applied. According to SWBT, if unrealistically low service quantities are used, the rates will be set higher than necessary to achieve the revenue objective. For example, if Northeast were to apply its proposed access rates to the actual usage paid for by SWBT in 1997 and to interLATA usage volumes which assume ten percent growth since 1996, they would produce revenue of approximately $16,575 over Northeast's 1996 access revenue[3]. *See* Exh. 10, page 5. SWBT

[3] SWBT did not have information about other carriers' usage levels or interLATA usage growth during this time period. However, SWBT's witness testified that if interLATA access usage remained the same as in 1996, the proposed rates would only produce a revenue reduction of $6,643 for Northeast when applied to SWBT's 1997 minutes of use. Exh. 10, page 6.

points out that the 1997 minutes of use are known and measurable and are therefore an appropriate adjustment to the test period. SWBT proposes that Northeast be required to update the access service quantities used to determine new rate levels.

The stipulating parties oppose SWBT's proposal to use 1997 minutes of use for a number of reasons. First, they emphasize that the 1997 usage levels were not known and measurable at the time the parties entered into their Agreement. They also assert that SWBT is "comparing apples to oranges." They assert that a higher level of use in 1997 would had produced higher revenues, as well, and that if SWBT wishes to use 1997 minutes to estimate the effects of the rate changes, then SWBT should compare its estimated 1997 revenues to actual 1997 revenues under the current rate structure to see whether the intended revenue reduction will be achieved by the proposed rate decreases. Second, they point out the clause in their Agreement which states that if the Agreement is not accepted in its entirety by the Commission, it will not be binding on the signatories. They assert that if the Commission attempts to place any conditions on the Agreement, then the Agreement will be null and void, the Staff will have to complete a full overearnings investigation and the Commission will have to conduct a full blown rate case. The signatory parties also dispute SWBT's assertion that using 1996 minutes of use will result in a revenue increase or only a very small revenue decrease. They suggest that if 1997 minutes of use are to be used to calculate access rates, then 1997 revenue would also have to be used. The parties did not submit 1997 revenue information.

C. Summary

The Commission finds that SWBT has not met its burden of demonstrating that the signatory parties' proposal to equalize intraLATA and interLATA access rates and to eliminate the CCL cap is inappropriate or unfair. SWBT emphasizes that the access rates are not, and have never been, cost justified, but also acknowledges that the costs of providing interLATA and intraLATA service are not significantly different. Exh. 10, p. 8. While SWBT complains that intraLATA service providers have contributed more to Northeast's access revenues than have interLATA service providers, it ignores the fact that interLATA service providers have contributed more per minute of use than have intraLATA service providers. *See* Schedule 1 to Exhibit 8. SWBT's argument that past levels of contribution should form the basis of future revenue decreases is not convincing on the record before the Commission.

Moreover, the Commission finds SWBT's allegations that the rates proposed by the signatory parties will result in a revenue increase or only a slight revenue decrease when applied to current usage levels unconvincing. SWBT's examples are based solely on SWBT's actual 1997 minutes of use and not on actual data concerning all carriers' minutes of use. Exh. 10, pp. 5-6. Staff's response to SWBT's allegations is convincing. The Commission finds that it is not necessary to use 1997 usage levels to calculate the rates necessary to achieve the intended $222,595 revenue reduction. The Commission finds that it would be inappropriate to update the test year to include 1997 minutes of use without also updating the test year to include actual 1997 revenues. Northeast's actual 1997 revenues are not in the record.

Overall, the Commission finds that the Agreement is in the public interest because it is designed to decrease Northeast's revenues as quickly as possible by an amount that all parties consider to be appropriate. The Commission finds that the Agreement will accomplish its stated objective of reducing Northeast's access revenues by approximately $222,595 annually. The Commission finds that the Agreement will reduce some of the highest access rates charged in Missouri and will therefore benefit all ratepayers. Finally, the Commission finds that the revenue design in the Agreement and implementing tariffs is in the public interest because it is fair to all carriers in the competitive environment that is being developed pursuant to the Telecommunications Act of 1996. For these reasons, the Commission finds that the rate design proposed by Northeast, Staff, OPC and AT&T is appropriate and should be approved.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

The extent of the Commission's jurisdiction over the proposed Agreement and tariff is defined by the following statutes:

> The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter:
>
> (2) To all telecommunications facilities, telecommunications services and to all telecommunications companies . . . , *except that nothing contained in this section shall be construed as conferring jurisdiction upon the Commission over the rates charged by a telephone cooperative* for providing telecommunications service within an exchange or within a local calling scope as determined by the commission, *except for exchange access service;*

§ 386.250, RSMo Supp. 1997 (emphasis added). *See also* § 392.220.5, RSMo Supp. 1997. A "telephone cooperative" is defined to be a telecommunications company:

> . . . in which at least ninety percent of those persons and corporations subscribing to receive local telecommunications service from the corporation own at least ninety percent of the corporation's outstanding and issued capital stock and in which no subscriber owns more than two shares of the corporation's outstanding and issued capital stock.

§ 386.020(54), RSMo Supp. 1997. Northeast asserted, and no party disputed, that Northeast is a telephone cooperative. The Commission therefore has jurisdiction to approve or reject any proposed change in Northeast's access rates. Based upon its findings, above, the Commission concludes that the proposed changes in Northeast's access rates are in the public interest and should be approved.

The Commission does not conclude that lowering access rates, or equalizing access rates, will necessarily be the best application of a revenue reduction in any other cases involving small incumbent local exchange carriers, whether or not they are cooperatives. The Commission notes that numerous cases are pending before it in which SWBT is opposing agreements submitted by Staff and other small incumbent local exchange carriers on the same grounds that it opposes the Agreement in this case. The Commission's decision in this case shall not be construed as reaching the general question of whether stipulated revenue reductions that are proposed by small incumbent local exchange carriers and involve lowering or equalizing access rates or eliminating CCL caps should be approved.

IT IS THEREFORE ORDERED:

1. That the hearsay and foundation objections to Exhibit 14HC are overruled, and that the relevance objection to pages 1 through 6 of Exhibit 14HC is sustained.

2. That pages 1 through 6 of Exhibit 14HC are rejected, and page 7 of Exhibit 14HC is admitted.

3. That Exhibits 11, 12, 13, 16 and 16HC are admitted.

4. That the Stipulation and Agreement signed by the Commission's Staff, the Office of the Public Counsel, Northeast Missouri Rural Telephone Company and AT&T Communications of the Southwest, Inc. is approved.

5. That the tariff filed by Northeast Missouri Rural Telephone Company on December 8, 1997, is approved to become effective on August 21, 1998. The tariff approved is:

P.S.C. MO. No. 2 Consolidated

4th Revised Sheet No. A.1	Canceling 3rd Revised Sheet No. A.1
4th Revised Sheet No. A.1.1	Canceling 3rd Revised Sheet No. A.1.1

6. That this Report and Order shall not be construed as addressing whether stipulated revenue reductions that are proposed by small incumbent local exchange carriers and involve lowering or equalizing access rates or eliminating CCL caps in other cases should be approved.

7. That this Report and Order shall become effective on August 28, 1998.

BY THE COMMISSION

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Murray, Schemenauer
and Drainer, CC., concur.
Crumpton, C., dissents.

Dated at Jefferson City, Missouri,
on this 18th day of August, 1998.